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C O N F I D E N T I A L SECTION 01 OF 02 QUITO 000945

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E.O. 12958: DECL: 04/27/2015
TAGS: PGOV ECON EFIN EC
SUBJECT: FINANCIAL INSTITUTIONS NERVOUS ABOUT ECUADOR'S FISCAL POLICY

REF: QUITO 900

Classified By: Amb. Kristie A. Kenney for reasons 1.4 (b) and (d).

¶1. (C) Summary. Our meetings with the financial and business sectors reveal uneasiness with the fiscal policies being espoused by the new Minister of Finance, Rafael Correa (Reftel). The international financial institutions (IFIs) found Correa,s proposed economic remedies to be nave and outdated. Citigroup Ecuador President noted that the Finance Minister,s initial statements had hurt Ecuador's risk ratings, but no capital flight had yet occurred. The local American Chamber of Commerce is troubled about the GOE,s new tone toward U.S. investors. All are taking a proactive approach to the new administration, reaching out to key GOE officials to promote dialogue. We are continuing to do the same. End Summary.

Financial Sector "Iffy" on Fiscal Policies

¶2. (C) The Ambassador met with the leading international financial institutions (World Bank, Inter-American Development Bank, International Monetary Fund) and Citigroup Ecuador President on April 26 to discuss the rhetoric and proposed fiscal policies of the new Minister of Finance, Rafael Correa. The IFIs had met with Correa earlier that day and expressed genuine concern about his approach. Correa grudgingly acknowledged the error of his initial rash and hasty commentary, but nonetheless railed against the Gutierrez government's fiscal policies, citing an increase in unemployment from 8% to 12% and persistent poverty. He advocated a more "activist" fiscal policy to stimulate and protect job growth, by raising import duties and expanding public bank loans. He told the IFIs that the GOE would pay its international debts if it "has the liquidity".

¶3. (C) The IFIs heard Correa out, then gently pointed out that Ecuador's historically low inflation is good for all sectors of the economy, that export-led growth had been proven more effective than protectionism, and that fiscal discipline was necessary to attract investment. The World Bank was particularly cautious because of its pending USD 100 million disbursement to Ecuador to promote fiscal consolidation and competitiveness. The World Bank is coming under increasing pressure to review and reconsider this disbursement aimed at rewarding past government fiscal behavior and, more importantly, to encourage and promote future discipline he told the Ambassador. Correa, who seems to have abandoned the possibility of changing the currency, did not raise the issue of dollarization.

¶4. (C) The Citigroup President, also concerned, highlighted some calming factors. First, there has not been a run on the banks. He confessed that investors are nervous, but no one is pulling out yet, mainly because of dollarization. He also commented that the GOE is financially in good shape. It has nine to ten months of cash reserves and is not facing tough imminent spending choices - thanks to high oil prices.

¶5. (C) The Ambassador held a separate meeting with the American Chamber of Commerce Steering Committee about what they perceive as the government's anti-U.S. sentiment. The Ambassador calmed these fears, noting that, during the entire political drama, there were no anti-Amcit or U.S. business security incidents. She felt, and AmCham members agreed, that commercial disputes would be set back, as we have lost our GOE interlocutors, those that were intimately familiar with the disputes and moving on them. The reality, she noted, is that we are starting over with this government and all must begin to engage and educate the new players.

Positive, Proactive, Pragmatic

¶6. (C) The financial players all agreed that the three "P"s should govern their approach to the new administration. By engaging relevant Ministers early and often and promoting productive and informative dialogue in a spirit of cooperation, they stand a better chance of tempering bad

policy and avoiding rash decisions. The Merck Pharmaceutical representative had concerns about President Palacio,s predilection for socialized medicine, but he said that Merck already knows President Palacio (a cardiologist) and the Minister of Health well and will engage them to help inform them about the pitfalls of this approach.

Comment

¶7. (C) The fact of the matter is that we and the IFIs must deal with the new administration, if only to alert its members to the risks of ill-considered policy options. We have advised the IFIs and the private sector to be as proactive as they can and to keep us abreast of progress or shortcomings. We will continue to follow commercial disputes closely. Although President Palacio struck a balanced tone in his meeting with the Ambassador on bilateral issues, others in his administration might not have found the religion yet. We will do our best to convert them.

KENNEY